

return year beginning before January 1, 1995, and the distribution does not cause a negative adjustment under the investment adjustment rules in effect at the time of the distribution. See paragraph (h)(5) of this section for the rules in effect with respect to the distribution.

(4) *Expiring loss carryovers.* If S became a member of a consolidated group in a consolidated return year beginning before January 1, 1995, and S had a loss carryover from a separate return limitation year at that time, the group does not treat any expiration of the loss carryover (even if in a tax year beginning on or after January 1, 1995) as a noncapital, nondeductible expense resulting in a negative adjustment under this section. If S becomes a member of a consolidated group in a consolidated return year beginning on or after January 1, 1995, and S has a loss carryover from a separate return limitation year at that time, adjustments with respect to the expiration are determined under this section.

(5) *Prior law—(i) In general.* For prior determinations, see prior regulations under section 1502 as in effect with respect to the determination. See, e.g., §§1.1502-32 and 1.1502-32T as contained in the 26 CFR part 1 edition revised as of April 1, 1994.

(ii) *Continuing basis reductions for certain deconsolidated subsidiaries.* If a subsidiary ceases to be a member of a group in a consolidated return year beginning before January 1, 1995, and its basis was subject to reduction under §1.1502-32T or §1.1502-32(g) as contained in the 26 CFR part 1 edition revised as of April 1, 1994, its basis remains subject to reduction under those principles. For example, if S ceased to be a member in 1990, and P's basis in any retained S stock was subject to a basis reduction account, the basis remains subject to reduction. Similarly, if an election could be made to apply §1.1502-32T instead of §1.1502-32(g), the election remains available. However, §§1.1502-32T and 1.1502-32(g) do not apply as a result of a subsidiary ceas-

ing to be a member in tax years beginning on or after January 1, 1995.

[T.D. 8560, 59 FR 41685, Aug. 15, 1994, as amended by T.D. 8677, 61 FR 33323, June 27, 1996; T.D. 8560, 62 FR 12098, Mar. 14, 1997; T.D. 8823, 64 FR 36099, July 2, 1999; T.D. 8984, 67 FR 11040, Mar. 12, 2002]

§ 1.1502-32T Investment adjustments (temporary).

(a) through (b)(4)(iv) [Reserved]. For further guidance, see §1.1502-32(a) through (b)(4)(iv).

(v) *Special rule for loss carryovers of a subsidiary acquired in a transaction for which an election under §1.1502-20T(i)(2) is made—(A) Expired losses.* Notwithstanding §1.1502-32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under §1.1502-20T(i)(2) and such loss carryovers expire or would have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv) and at all times thereafter, the group will be deemed to have made an election under §1.1502-32(b)(4) to treat all of such expired loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group.

(B) *Available losses.* Notwithstanding §1.1502-32(b)(4)(iv), to the extent that S's loss carryovers are increased by reason of an election under §1.1502-20T(i)(2) and such loss carryovers have not expired and would not have been properly used to offset income in a taxable year for which the refund of an overpayment is prevented by any law or rule of law as of the date the group files its original return for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv) and at all times thereafter, the group may make an election under §1.1502-32(b)(4) to treat all or a portion of such loss carryovers as expiring for all Federal income tax purposes immediately before S became a member of the consolidated group. Such election must be filed with the group's original return

for the taxable year in which S receives the notification described in §1.1502-20T(i)(3)(iv).

(C) *Effective date.* This paragraph (b)(4)(v) is applicable on and after March 7, 2002.

(c) through (h)(5)(ii) [Reserved]. For further guidance, see §1.1502-32(c) through (h)(5)(ii).

[T.D. 8984, 67 FR 11040, Mar. 12, 2002]

§ 1.1502-33 Earnings and profits.

(a) *In general*—(1) *Purpose.* This section provides rules for adjusting the earnings and profits of a subsidiary (S) and any member (P) owning S's stock. These rules modify the determination of P's earnings and profits under applicable rules of law, including section 312, by adjusting P's earnings and profits to reflect S's earnings and profits for the period that S is a member of the consolidated group. The purpose for modifying the determination of earnings and profits is to treat P and S as a single entity by reflecting the earnings and profits of lower-tier members in the earnings and profits of higher-tier members and consolidating the group's earnings and profits in the common parent. References in this section to earnings and profits include deficits in earnings and profits.

(2) *Application of other rules of law.* The rules of this section are in addition to other rules of law. For example, the allowance for depreciation is determined in accordance with section 312(k). P's earnings and profits must not be adjusted under this section and other rules of law in a manner that has the effect of duplicating an adjustment. For example, if S's earnings and profits are reflected in P's earnings and profits under paragraph (b) of this section, and S transfers its assets to P in a liquidation to which section 332 applies, S's earnings and profits that P succeeds to under section 381 must be adjusted to prevent duplication.

(b) *Tiering up earnings and profits*—(1) *General rule.* P's earnings and profits are adjusted under this section to reflect changes in S's earnings and profits in accordance with the applicable principles of §1.1502-32, consistently applied, and an adjustment to P's earnings and profits for a tax year under this paragraph (b)(1) is treated as earn-

ings and profits of P for the tax year in which the adjustment arises. Under these principles, for example, the adjustments are made as of the close of each consolidated return year, and as of any other time if a determination at that time is necessary to determine the earnings and profits of any person. Similarly, S's earnings and profits are allocated under the principles of §1.1502-32(c), and the adjustments are applied in the order of the tiers, from the lowest to the highest. However, modifications to the principles include:

(i) The amount of P's adjustment is determined by reference to S's earnings and profits, rather than S's taxable and tax-exempt items (and therefore, for example, the deferral of a negative adjustment for S's unabsorbed losses does not apply).

(ii) The tax sharing rules under paragraph (d) of this section apply rather than those of §1.1502-32(b)(3)(iv)(D).

(2) *Affiliated earnings and profits.* The reduction in S's earnings and profits under section 312 from a distribution of earnings and profits accumulated in separate return years of S that are not separate return limitation years does not tier up to P's earnings and profits. Thus, the increase in P's earnings and profits under section 312 from receipt of the distribution is not offset by a corresponding reduction.

(3) *Examples*—(i) *In general.* For purposes of the examples in this section, unless otherwise stated, P owns all of the only class of S's stock, the stock is owned for the entire year, S owns no stock of lower-tier members, the tax year of all persons is the calendar year, all persons use the accrual method of accounting, the facts set forth the only corporate activity, preferred stock is described in section 1504(a)(4), all transactions are between unrelated persons, and tax liabilities are disregarded.

(ii) *Tiering up earnings and profits.* The principles of this paragraph (b) are illustrated by the following examples.

Example 1. Tier-up and distribution of earnings and profits. (a) *Facts.* P forms S in Year 1 with a \$100 contribution. S has \$100 of earnings and profits for Year 1 and no earnings and profits for Year 2. During Year 2, S declares and distributes a \$50 dividend to P.

(b) *Analysis.* Under paragraph (b)(1) of this section, S's \$100 of earnings and profits for